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Capital Spending in the Current Healthcare Environment

The downturn of the U.S. economy has had a significant impact on the healthcare industry, with many hospitals and healthcare systems continuing to struggle in its wake. The current capital environment is the result of multiple factors, including: the recent economic downturn of indefinite duration; the failure of the market to rebound to pre-recession levels; the uncertainty surrounding the state of healthcare reform; limited access to capital; and, ongoing issues related to reimbursement.[1] For many in the industry, the present economic climate has altered the types of capital expenditures they are seeking to undertake, as well as their ability to obtain the necessary funding for these projects.[2] Persisting negative effects of the recession have led to uncertain long-term projections on capital spending within healthcare.[3] Despite the recession, recent data suggests that healthcare leaders are still committed to capital spending and are confident they will be able to secure funding for future projects.[4]

In a survey conducted in late 2011, Premier, Inc. found that 69 percent of healthcare organizations had a capital budget that had remained stable or increased from the previous year.[5] Of those surveyed, most organizations indicated that their future spending would be directed toward information technology and telecommunications.[6] A similar survey conducted by HealthLeaders Media indicated 39 percent of healthcare organizations will dedicate the majority of their 2012 capital funds to electronic medical record systems, reflecting the organizations' need to meet the technology mandates imposed by the Patient Protection and Affordable Care Act (ACA).[7] Capital investments in infrastructure were the second prominent dedication of 2011 funds, as 60% of Premier's respondents expected an increase in patient admissions. Organizations indicated that growth would occur through the construction of new hospitals and other facilities (30 percent) and investment in surgical suites and imaging equipment (10 percent).[8] Over half of organizations cited "*improvement to the quality of care*" as the primary reason for their capital allocation; 34 percent indicated "*replacement need*," and only 14 percent cited "*return on investment*" as their main justification.[9]

Despite the stabilizing capital budgets and projected increases in patient admissions, obtaining funding for projects may prove problematic for healthcare organizations, particularly those with non-profit status. Although some non-profit entities utilize traditional taxable financing, more recently, many have turned to low-interest, tax-exempt bond debt as a source of funding.[10] This new trend may be due to the recession's negative impact on the availability of alternative funding sources, i.e., grants and charitable donations.[11] Although tax-exempt financing offers multiple advantages, such as lower interest rates and exemption from several federal and state security law requirements, these bonds have become more difficult to obtain over the past several years, especially for organizations without an investment-grade credit rating.[12] Organizations with an investment-grade rank under "BBB" may find most banks reluctant to lend to them.[13] In the current economic climate, most healthcare organizations (81 percent) are relying on internal capital sources; 47 percent are turning to endowments or charitable donations; and, 33 percent are using tax-exempt bonds.[14]

With respect to external funding eligibility, most respondents described their organization's financial profile as "*average profitability, average liquidity, and moderate debt burden*." Although 22 percent of respondents described their organization as having "*high profitability, high liquidity, and limited debt burden*," nine percent of respondents indicated their organization was "*not profitable, not liquid*," and had "*significant debt burden*."[15] In response to the recent economic downturn, most organizations have focused on building their liquidity and capital holdings in order to avoid taking on new debt to fund projects, but as the market continues to improve, organizations may be more willing to assume new debt where sensible.[16]

Overall, the economy has produced mixed results with respect to healthcare organizations' capital spending. In response to a recent multi-response poll concerning the impact of the economic crisis, 40 percent of healthcare organizations report having completely eliminated some of their capital projects; 48 percent of these organizations also report delayed capital projects; and, only 29 percent have continued with their projects as originally budgeted.[17] As the economy slowly heads into a recovery phase, 43 percent of healthcare organizations expect an increase in their operating income and expenses, and most anticipate that capital

(Continued on next page)

expenses would account for one to ten percent of their organization's overall budget.[18]

Though the state of the economy and ongoing healthcare reform efforts limit forecasting of long-term trends in organizations' capital spending, it is clear that technology-focused projects will dominate the short-term spending landscape. Approaching deadlines by which healthcare providers must achieve "*meaningful use*" of electronic health record systems has forced many organizations to dedicate capital funds toward implementing technology.[19] In addition, current trends in physician-hospital alignment; clinical integration (i.e., accountable care organizations and patient-centered medical homes); evidence-based medicine; and, value-based purchasing reimbursement initiatives all require significant technical support and will all influence the future allocation of capital spending within healthcare. Government and industry support of these emerging trends may also impact the ease with which healthcare entities access capital despite continued economic limitations.

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3 "2011 Capital Spend: EMR Dominates Budgets" By Karen Minich-Pourshadi, HealthLeaders Media Intelligence Report, March 2011, p.11.

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5 "Behind the Numbers: Financial and Economic Trends Impacting Our Members" Premier, Inc., Economic Outlook: A Twelve Month Outlook, (September 2011), Charlotte, NC: Premier, Inc., p. 48.

6 "Behind the Numbers: Financial and Economic Trends Impacting Our Members" Premier, Inc., Economic Outlook: A Twelve Month Outlook, (September 2011), Charlotte, NC: Premier, Inc., p. 51.

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10 "Restructuring Challenges of Tax-Exempt Bond Financing for Health Care Facilities" By Nancy A. Peterman et al., American Bankruptcy Institute Journal, December/January 2011, p. 18.

11 "Restructuring Challenges of Tax-Exempt Bond Financing for Health Care Facilities" By Nancy A. Peterman et al., American Bankruptcy Institute Journal, December/January 2011, p. 18.

12 "Capital Spending Strategies in an Economic Recovery" By John Commins, HealthLeaders Media, http://www.healthleadersmedia.com/content/FIN-277535/Capital-Spending-Strategies-in-an-Economic-Recovery (Accessed 3/23/12).

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16 "2011 Capital Spend: EMR Dominates Budgets" By Karen Minich-Pourshadi, HealthLeaders Media Intelligence Report, March 2011, p.12.

17 "2011 Capital Spend: EMR Dominates Budgets" By Karen Minich-Pourshadi, HealthLeaders Media Intelligence Report, March 2011, p.13.

18 "2011 Capital Spend: EMR Dominates Budgets" By Karen Minich-Pourshadi, HealthLeaders Media Intelligence Report, March 2011, p.16.

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(Continued on next page)

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